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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 183.

B. H. Inness Brown, David Paine, Ethelbert Warfield, J. Fearon Brown, George Koegler, and Murray MacElhinny, individually and as co-partners under the firm name of Kellogg, Emery & Inness-Brown,

and

Lawrence S. Greenbaum, Edward S. Greenbaum, Herbert A. Wolff, Morris L. Ernst, Jonas J. Shapiro, Wallace D. Jennings, Samuel J. Schur and Alexander Lindey, individually and as co-partners under the firm name of Greenbaum, Wolff & Ernst,

Petitioners,

—against—

John Gerdes and James D. Carpenter, Jr., Trustees of Reynolds Investing Co., Inc., Debtor,

Respondents.

On Petition for Writ of Certiorari to the Court of Appeals of the State of New York.

BRIEF OF REORGANIZATION TRUSTEES.

JOHN GERDES,
JAMES D. CARPENTER, JR.,
As Trustees of Reynolds Investing Company, Inc., Debtor, Pro Se,
Respondents.

John Gerdes,
Mary-Chase Clark,
Of Counsel.

December 8, 1943.

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BRIEF OF REORGANIZATION TRUSTEES.

Opinions Below.

The opinions of the state Supreme Court appear on pages 98 to 113 of the record and are not officially reported. The Appellate Division wrote no opinion. The opinion of the state Court of Appeals and dissent appear on pages 124 to 129 of the record, and are reported in 290 N. Y. 468.

Statutes Involved.

The provisions of the Bankruptcy Act and other federal and state statutes involved, are set forth in the Appendix to this brief.

Outline of Case.

This Court is asked to review the refusal of the New York court to fix the compensation to be paid to attorneys (hereinafter referred to as the "Attorneys") appointed by a federal district court in a reorganization proceeding under the Bankruptcy Act to bring and prosecute suits in a state court upon causes of action constituting assets of the estate of the debtor.

The reorganization trustees (hereinafter referred to as the "Trustees"), under authority conferred by the federal reorganization court, opposed the fixing of the Attorneys' fee by the state court on the following grounds:

1. The Attorneys have entered into an express or implied contract that the amount of their fee is to be fixed by the federal reorganization court.

2. Even if there were no contract binding the Attorneys to the fixation of their fee by the federal reorganization court, such court has exclusive jurisdiction over the fixing of allowances to attorneys appointed by it to prosecute, in behalf of debtors in possession or trustees, causes of action which are assets of the estate of the debtor.

3. Section 475 of the New York Judiciary Law does not grant a lien under circumstances such as exist in this situation. In any event, no lien may be secured against assets of a debtor during the pendency of a proceeding under Chapter X of the Bankruptcy Act.

4. No state court, without the consent of the reorganization court, may enforce a lien against assets of a debtor during the pendency of a proceeding under Chapter X of the Bankruptcy Act. Such consent was not given by the reorganization court or Trustees.

5. The Attorneys are bound by the plan of reorganization—approved, confirmed and consummated with their active approval and consent—which expressly provides that their fee is to be fixed by the federal reorganization court. The plan, and order confirming it, are *res judicata;* they cannot be attacked collaterally in a state court.

The state Court of Appeals held:

1. That the Attorneys have bound themselves by contract to permit the federal reorganization court to fix the value of their services; and

2. That even if there were no contract to that effect, the federal reorganization court has exclusive jurisdiction, under the Federal Constitution, the Bankruptcy Act, and other federal statutes, to fix the reasonable value of the services of attorneys appointed by it to assist in the administration of an estate in reorganization proceedings under the Bankruptcy Act.

As its decision on these matters determined the issues, the state Court of Appeals did not pass upon the other questions.

Facts.

A petition for the reorganization under Section 77B of the Bankruptcy Act of Reynolds Investing Company, Inc. (hereinafter called the Debtor) was filed on May 18, 1938, in the United States District Court for the District of New Jersey (R. 11). The petition was approved, and the Trustees were appointed on January 19, 1939 (R. 12), under the provisions of Chapter X of the Bankruptcy Act (Chandler Act) which had become applicable to the proceeding on September 22, 1938 (Bankruptcy Act, section 276c(1)).

After jurisdiction had been conferred on it by the filing of the petition, the reorganization court made an order (dated August 1, 1938) appointing the Attorneys, as attorneys for the Debtor, to institute and prosecute in the New York courts certain claims in favor of the Debtor against its former officers, directors and others (R. 12). Action in the New York court was started August 4, 1938 (R. 12). After their appointment, the Trustees, by order dated February 10, 1939, were substituted as parties plaintiff in place of the Debtor (R. 12).

In November 1939 the Attorneys, who were also the attorneys for the two most important creditor and stockholder committees in the reorganization proceeding,* ap-

* The Attorneys received $36,000 in allowances from the reorganization court for their services as attorneys for these committees (R. 28).

proved the plan of reorganization proposed by the Trustees and urged the Court, creditors, stockholders, and other interested parties, to approve and accept the plan (R. 30). The plan so approved expressly provides that the federal reorganization court retains jurisdiction to "fix the reasonable compensation to be paid to the Trustees, and their attorneys or counsel, for services in the prosecution of" the claims being prosecuted in the New York court by the Attorneys (R. 29).

Some changes were made in the plan originally proposed by the Trustees in October 1939 and approved by the Attorneys in November 1939, but no change was ever requested or made in the provisions which reserve to the federal reorganization court jurisdiction over the determination of the value of the Attorneys' services. The plan of reorganization, which was confirmed (R. 31) by the court by order dated June 17, 1940, and fully consummated* in 1940 (R. 30), contains the same reservation of jurisdiction of the federal reorganization court over the fixing of the compensation of the Attorneys for their services in the state court (R. 52).

The Attorneys performed most of the services for which they seek compensation *after* they had approved the plan, and after the plan had been confirmed and consummated. They prepared for trial, conducted a six weeks trial in the New York court during the early part of 1941, conducted hearings before a state court referee in the summer of 1941, and entered judgment in favor of

* The reorganization proceeding was terminated, except for the reserved jurisdiction of the reorganization court and the Trustees over the claims being prosecuted by the Attorneys, and other unsettled or unadjusted claims of the Debtor and its estate, as required by Section 216(13) of the Bankruptcy Act.

the Trustees in the state court in November 1941 (R. 14, 15).

In June 1941 the Trustees, under authority from the federal reorganization court, notified the Attorneys that after the Attorneys completed the reference then pending and entered judgment in the action, their services for the Trustees were to discontinue (R. 22, 23). No other attorneys were substituted in the New York action for the Attorneys. The Trustees did not appear *pro se* therein. The judgments entered by the Attorneys in favor of the Trustees in the New York action against the principal defendants, because the defendants had no assets which would enable collection of a larger amount, were settled for $150,000 with the approval of the federal reorganization court after hearings upon notice to the Attorneys, the Securities and Exchange Commission, all creditors and stockholders, and other parties in interest. This sum of $150,000 is being held in escrow for the protection of the Attorneys, pending the determination of this appeal.

The Trustees made a motion in the federal court to compel the Attorneys to deliver to the Trustees the papers and exhibits in the New York actions. The Attorneys contested the jurisdiction of the federal court and asserted that the New York court had exclusive jurisdiction.

Following the suggestion of this Court in *Gross* v. *Irving Trust Co.*, 289 U. S. 342, at page 345 (that the federal court might well instruct its trustee in bankruptcy "to request the state court to recognize the exclusive jurisdiction of the" federal court "before taking final action"), the Trustees, with the consent of the federal court, withdrew their motion in the federal court

under a written stipulation (R. 24-26) which permitted the Attorneys to present the questions to the state court, with an express reservation of the right of the Trustees to question the jurisdiction of the state court (R. 26).

After the foregoing state court action had been terminated by the entry of final judgment on November 5, 1941 (R. 15), a separate and independent proceeding was brought by the Attorneys in the state court (by petition dated December 22, 1941) to fix the value of the services rendered by them in the aforesaid action and in two other actions (hereinafter referred to as Action No. 2 and the Globe Action), and to enforce liens for such services.

The Trustees objected to the jurisdiction of the state court. The state court overruled the objections to its jurisdiction and fixed $100,000 as the value of the services rendered in the aforesaid action, adding $2,250 for interest from November 27, 1941 to April 15, 1942, the date of the entry of its order (R. 7). When it fixed these amounts the state court knew that a proceeding was pending before the federal court to settle for $150,000 the judgments against the principal defendants (R. 93, 94).

The order of the state court adjudged the Attorneys to have a lien for the aforesaid sum upon the judgment entered in the New York action against the old Reynolds directors and upon "the proceeds thereof in whatever hands they may come" (R. 7), and provided, further, that the Attorneys could apply to the said state court "for additional and further relief to enforce said lien" (R. 8).

On appeal, the state Appellate Division affirmed the lower court, without opinion. The state Court of Appeals reversed, and dismissed the proceeding.

After instituting the principal action in the New York court, and after the appointment of the Trustees under Chapter X, the Attorneys were authorized to bring two additional actions in behalf of the Trustees in the New York court: the action designated as Action No. 2, and the action designated as the Globe Action.

There was no substitution of attorneys or of the Trustees *pro se*, and no application for such substitution, in Action No. 2. The action—which involved some of the defendants who were defendants in Action No. 1—was settled in conjunction with the settlement of Action No. 1. The aforesaid sum of $150,000 is also held in escrow, pending the determination of this appeal, for the protection of the Attorneys for services in Action No. 2. The allowance by the lower state court for such services was $2000.

The Globe action has been abandoned. Neither the Attorneys nor the Trustees believe that there is a reasonable prospect of recovery. No substitution or application for substitution of attorneys or of the Trustees *pro se* has been made. Nothing has been done in the action since the Attorneys discontinued their services. The fund of $150,000 is also held in escrow, pending the determination of this appeal, for the satisfaction of any claim which may be established by the Attorneys for their services in this action. The allowance to the Attorneys by the lower state court for their services was $750.

Additional facts are set forth in the argument of the Points.

Error in the Record.

An important error appears in the record on page 124. It is stated, as part of the official report of the opinion of the Court of Appeals, that the appeal to the Court of Appeals was "on constitutional grounds from an order of the Appellate Division". The correct statement, as found in the official reports, *Matter of Brown (Gerdes)*, 290 N. Y. 468, is: "Appeal, by permission of the Court of Appeals, from an order of the Appellate Division."

The New York practice permits appeals to the Court of Appeals as of right (on constitutional questions), or by permission of the Appellate Division or the Court of Appeals (in which case the Court of Appeals is not restricted to the consideration of constitutional questions).

The Trustees appealed both as of right and with the permission of the Court of Appeals (R. 123). The Court considered local state questions of law as well as constitutional questions.

Position of the Trustees.

Whether the Attorneys have a lien for their services is not a matter of great importance to them in this case. There is no doubt that any claim which they may legally establish will be paid in full.

As stated by the Attorneys themselves in their petition in the lower state court (R. 19-20), the plan prepared by the Trustees and confirmed and consummated in the reorganization proceeding provides that "the [reorganized]

Company is compelled to keep available $300,000 of its assets to assure payment of expenses incurred in the prosecutions of these claims". In addition, the Trustees have voluntarily agreed to the holding of $150,000 in cash—proceeds of the settlement of the New York action—in escrow for the satisfaction of the Attorneys' claim.

The really important question to those interested in the Reynolds reorganization is whether the state court may fix the *amount* of compensation to be paid out of the reorganization estate to these Attorneys, appointed by the reorganization court, for services as Attorneys for the Trustees in the administration of assets of the reorganization estate. (The state court has fixed the compensation to the Attorneys at $100,000, plus $2250 interest and costs, although the total collection by the estate on settlements of the action with all solvent defendants is approximately $190,000.)

Other questions of general importance in the administration of estates under Chapter X of the Bankruptcy Act, are involved.

Summary of Argument.

(1) Questions of local state law:

(a) The Attorneys have agreed that the *amount* of their compensation is to be fixed by the federal reorganization court. Their contract was not abrogated by a wrongful discharge. They were permitted to complete the services for which they had been employed. (Point I.)

(b) Section 475 of the New York Judiciary Law does not grant a *lien* under the circumstances of this case. (Point II.)

(2) Questions of federal law:

(a) The Attorneys are bound by the plan of reorganization and the order confirming it, both of which provide that the federal reorganization court shall fix the fee of the Attorneys. The federal court order and plan are *res judicata* and cannot be attacked collaterally in a state court. (Point III.)

(b) Even if no implied or express agreement gives it such jurisdiction, the federal reorganization court has exclusive jurisdiction to fix the compensation of attorneys appointed by it to assist its Trustees in the collection of assets by suits in state courts. (Point IV.)

(c) No lien on assets of a debtor can be secured during the pendency of a proceeding under Chapter X of the Bankruptcy Act. (Point V.)

(d) No state court, without the consent of the reorganization court, may enforce a lien against assets of a debtor during the pendency of a proceeding under Chapter X. (Point VI.)

(e) The United States District Court and the Trustees did not, directly or indirectly, confer jurisdiction upon the state court to fix the *amount* of the allowance to be made to the Attorneys; nor did they confer jurisdiction upon the state court to enforce any claimed *lien*. (Point VII.)

(f) The case of *Sherman* v. *Buckley* and the *Cup Craft* cases are not in point. (Point VIII.)

(g) No other federal or state court decisions are in conflict with the decision of the state court herein. (Point IX.)

POINT I.

The Attorneys have bound themselves by contract to the fixation of their fees by the federal reorganization court.

The Attorneys herein agreed to the fixation of their compensation by the federal reorganization court.

The plan of reorganization provides* (R. 52):

> "All claims in favor of the Debtor or of the Debtor's estate not settled or adjusted in the reorganization proceedings, or in the plan, or in connection with the consummation of the plan, shall be retained and enforced by the Trustees. * * *
>
> "The Court will retain continuing jurisdiction over such claims and the prosecution thereof * * * The Court will from time to time fix the reasonable compensation to be paid to the Trustees, *and their attorneys or counsel*, for services in the prosecution of such claims, * * *"

The Attorneys concede that the "claims" referred to in these provisions of the plan are the claims for the prosecu-

* These provisions are required by sections 216(13) and 221(4) of the Bankruptcy Act.

tion of which they seek compensation in the state court. They claim the benefits of another portion of the same paragraph of the plan from which the foregoing quotations have been taken—that portion of the paragraph under which the reorganized Debtor "is compelled to keep available $300,000 of its assets to assure payment of expenses incurred in the prosecution of these claims" (R. 52).

There were no other claims. The claims prosecuted in the Virginia action were the same claims—asserted against directors against whom service of process could not be made in New York.

The Attorneys approved the plan as early as November, 1939, and urged the creditors and stockholders represented by them to approve and accept it (R. 30).* The plan was confirmed by order dated June 17, 1940, and was consummated in 1940, with the active support of the Attorneys (R. 30).*

As the Attorneys approved the foregoing provisions of the plan, under which it was specified that their fees would be fixed by the federal court, before they conducted the trial of the New York action or performed the most important part of their services, the condition that their fee be fixed by the federal court was a part of their contract with the Trustees and the federal court. The state Court of Appeals so held (R. 128):

> "* * * would appear that both as a matter of law and as a matter of fact the retainer of these attorneys was subject to the condition that the amount of

* These allegations in paragraphs 11 and 12 of the Trustees' answer were expressly admitted in the reply of the Attorneys (R. 68).

any fees would be fixed by the United States District Court."

In addition, when the Attorneys accepted appointment by the federal court, the provisions of the Bankruptcy Act requiring the federal court to fix their fees became, by implication, a part of their contract. In its opinion the New York Court of Appeals said (R. 126):

> "Also, since these attorneys were appointed by the court in this reorganization proceeding and nothing was said as to fees, the services of the attorneys were undertaken subject to all the provisions of the Bankruptcy Act with respect to the compensation for such services. * * * Under such circumstances, even if no exclusive jurisdiction had been given to the Federal Court, the attorneys would in the normal course return to have their compensation fixed by the court by whom their appointment had been made."

In the state court the Attorneys conceded that if there were no wrongful discharge of the Attorneys by the Trustees, the state court would have no jurisdiction to fix their compensation. But they contended that under the state law they had been wrongfully discharged by the Trustees, and that such discharge abrogated their contract that the federal reorganization court was to fix their compensation, and gave jurisdiction to the state court.

The precise position taken by the Attorneys is shown by the following quotation from pages 7 and 8 of their brief on their motion for a reargument in the state Court of Appeals:

"Judge Finch, in the prevailing opinion, states that respondents fully performed the services for which they were retained. On that assumption he deems the issue presented on this appeal to be whether the New York Court had the power to grant an allowance to respondents for such completed services, and concludes that exclusive jurisdiction resided in the Bankruptcy Court. The facts as found by both courts below, however, are that respondents were discharged prior to the full performance of their services, that the actions which they were retained to prosecute were not completed and that appellants sought to substitute themselves in place of respondents in the pending New York actions.

"The issue on this appeal, therefore, is not whether the State Court has jurisdiction to grant allowances in general to attorneys appointed by the Bankruptcy Court after services have been completed by such attorneys. *On that proposition there is no dispute; where an attorney appointed by a Bankruptcy Court has completed his work, the fixing of his compensation and the granting of allowances are made by the Bankruptcy Court and all the provisions of the Bankruptcy Act referred to by Judge Finch, relating to allowances to attorneys in the Bankruptcy Court, become effective.*"

A. The Attorneys' Contract Was Not Abrogated by a Wrongful Discharge.

The Court of Appeals held that, as a matter of local state law, the Attorneys had not been wrongfully discharged, but had been permitted fully to perform the services for which they had been employed. The Court said (R. 128):

"* * * the attorneys herein were permitted fully to perform the services for which they were appointed, namely to reduce the claims to judgment. * * *"

It therefore appears that the state Court of Appeals held, as a matter of state law: (1) that the Attorneys were bound by contract to have their fee fixed by the federal reorganization court; and (2) that the contract had not been abrogated by a wrongful discharge of the Attorneys.

B. The Attorneys' Contract Is Not Abrogated by Section 475 of the New York Judiciary Law.

The contractual rights of attorneys, as to *amount* of compensation or method of fixing such compensation, are not affected by the provisions of Section 475 of the New York Judiciary Law. The section merely extends the common law charging lien of an attorney, in an appropriate case, by granting such lien as soon as the attorney's services commence instead of when the judgment is entered. *Matter of Heinsheimer*, 214 N. Y. 361.

Section 474 of the same law expressly provides that "the compensation of an attorney or counsellor for his services is governed by agreement, express or implied, which is not restricted by law", except where the services are rendered to the guardian *ad litem* for an infant.

POINT II.

Section 475 of the New York Judiciary Law does not grant a lien under the circumstances of this case.

In an excellent opinion on the nature of attorneys' liens, Judge Cardozo, in *Matter of Heinsheimer*, 214 N. Y. 361, at page 365, said that Section 475 of the New York

Judiciary Law merely enlarges the common law charging lien of an attorney "to the extent that it now attaches to a cause of action even before judgment" (p. 365). He stated, quoting with approval from a previous New York case, that such a lien is a "device invented by the courts for the protection of attorneys against the knavery of their clients" (p. 365) and (quoting from an English case) that "the facts of the case must be looked at to see whether the solicitor * * * has made with his client an arrangement which sufficiently indicates the intention of the parties that the right shall no longer be enforced" (p. 367). He stated (p. 368) that "a charging lien cannot exist unless it is an element, express or implied, of the agreement, that the lawyer is to be paid out of the fruits of the judgment".

Judge Cardozo held that an agreement under which an attorney is to receive periodic payments from his client is inconsistent with an intent that the attorney should have a lien under Section 475.

So, too, in this case, the facts are inconsistent with any intent that the Attorneys should have a lien.

The statute (Bankruptcy Act, Section 216 (3)) provides that the claim of the Attorneys, as an expense of administration, must be paid in full.

In addition, as stated by the Attorneys (R. 19, 20), the reorganized debtor, under the plan confirmed by the reorganization court with the active support of the Attorneys, "is compelled to keep available $300,000 of its assets to assure payment" of their claim.

The reorganization court, with the consent of the Attorneys, thus provided a special fund for the protection of the Attorneys, and it is not "an element, express or implied, of the agreement, that" they are "to be paid out of the fruits of the judgment".

POINT III.

The Attorneys are bound by the plan of reorganization and the order confirming it, both of which provide that the federal reorganization court shall fix the fee of the Attorneys. The federal court order and plan are *res judicata* and cannot be attacked collaterally in a state court.

The plan of reorganization provides that the federal reorganization court retains jurisdiction to "fix the reasonable compensation to be paid to the Trustees, and their attorneys or counsel, for services in the prosecution of" the claims prosecuted by these Attorneys (R. 52).

The plan also provides only for the payment of claims of creditors which have been proved in the proceedings and for the payment of such reorganization debts and expenses as are allowed by the federal reorganization court (R. 37, 55).

The order confirming the plan of reorganization provides that costs and expenses of administration shall be paid only if approved by the reorganization judge after a hearing upon proper notice under the Bankruptcy Act (R. 66).

The Attorneys are bound by the foregoing provisions of the plan and of the order confirming the plan. They were parties to the reorganization proceeding. They participated in the formulation of the plan and order of confirmation. They urged the court and the security holders' committees represented by them to approve and accept the plan and the order confirming it. Their time to appeal has long since expired. No appeal was taken.

The Attorneys have not filed or proved their claim in the reorganization proceeding. No claim by them has been approved by the reorganization judge.

Even if the federal reorganization court had acted beyond its power in confirming a plan containing these provisions—as was not the case—the Attorneys are bound by the plan and the order which confirmed it, which are *res judicata* as to them. They cannot attack the plan or order collaterally in a state court. *Stoll* v. *Gottlieb*, 305 U. S. 165.

POINT IV.

The United States District Court has sole power to fix the compensation to be paid to the Attorneys, as its agents and officers in the administration of the reorganization estate.

The Attorneys were appointed by the United States District Court to assist in the administration of the estate—to assist in the liquidation of assets. They are officers and agents of said Court.

Every court has exclusive control over the compensation to be paid out of assets administered by it to attorneys or officers appointed by it.

The case of *Fanning* v. *Poe*, 76 F. (2d) 707, is on all fours with the case now before this court, except that the positions of the state and bankruptcy courts were reversed.

In that case, a state court appointed receivers of the assets of a partnership. The partnership had a claim against a bankrupt. The state court authorized its receivers to employ an attorney to prosecute in the bankruptcy proceedings the claim of the state court receiver.

Subsequently, a controversy arose between the state court receivers and their attorney, appointed by the state court, as to the amount of the attorney's fee. The attorney, without submitting the matter to the state court, made an application to the bankruptcy court, asserting a lien on the claim. The referee in bankruptcy sustained the attorneys and recognized a lien.

Upon review, the lower federal court and the Circuit Court of Appeals reversed the referee. They held that only the court appointing the attorney could fix the amount of his fees. The United States Circuit Court of Appeals, in its opinion, 76 F. (2d) 707, at page 709, said:

> "Appellant is an attorney and counselor at law, appointed by and subject to the authority of a state court. * * * He may not take that appointment as the source of his authority to appear in the bankruptcy court, and, without permission of the court appointing him, look elsewhere for the fixing of his fees for so appearing. * * * An appointee of that court, he could not have retained any part of the moneys that court had authorized him to collect for it, except with its approval. *Lynde* v. *Lynde*, 64 N. J. Eq. 736, 52

A. 694, 58 L. R. A. 471, 97 Am. St. Rep. 692; *In re Gilbert*, 276 U. S. 294, 297, 48 S. Ct. 309, 72 L. Ed. 580; *In re Debbins* (D. C.), 53 F. (2d) 1018."

Congress in the exercise of its power over bankruptcies has, by statute, expressly recognized the foregoing principle and has vested bankruptcy and reorganization courts with exclusive power over the compensation of attorneys appointed by them.

Section 241 of Chapter X of the Bankruptcy Act gives control over the compensation of attorneys for trustees to the judge of the reorganization court.

Section 62 of the Bankruptcy Act, which is applicable to proceedings under Chapter X, provides (in subsection a) that the "actual and necessary costs and expenses incurred by officers in the administration of estates * * * be reported in detail, under oath, and examined and approved or disapproved by the court" (referring to the bankruptcy court). It also requires (in subsection d) that a trustee, or an attorney for the trustee, "or any other attorney, seeking compensation for services rendered by him in a proceeding, shall file with the court his petition setting forth the value and extent of services rendered, the amount requested and what allowances, if any, have theretofore been made to him."

Supplementing the foregoing sections, Section 221(4) of Chapter X of the Bankruptcy Act provides that the judge cannot confirm a plan of reorganization unless satisfied that all "costs and expenses in, or in connection with, the proceeding, or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable, or if to be fixed after con-

firmation of the plan, will be subject to the approval of the judge."

In this case, the plan has been confirmed. The amount to be paid for the services of the Attorneys is therefore "subject to the approval of the judge" (of the reorganization court).

Under these statutory provisions, attorneys employed to assert claims in behalf of a bankruptcy or reorganization estate in other courts must apply to the bankruptcy court for the fixation and allowance of their fees.

This Court, in *Page* v. *Rogers*, 211 U. S. 575, said that "the proper place to raise" the question as to the amount to be paid to the attorney for a bankruptcy trustee for services in a separate equity action was "in the bankruptcy court" and not in the equity court (p. 581).

In *Watkins* v. *Sedberry*, 261 U. S. 571, the trustee in bankruptcy had employed an attorney to prosecute a suit in a state chancery court to recover certain assets. The Court said (p. 575) that the attorney's fee for services in the state court action was "an expense of administration" of the bankruptcy proceeding, and was "subject to the examination and approval" of the bankruptcy court.

In *Davidson* v. *Friedman*, 140 Fed. 853, the attorney rendered services in the realization of assets for the trustee. The court, at page 853, said:

> "The matter involved in the present appeal is an expense incurred by the trustee in the course of his administration."

In *In re Stemper*, 222 Fed. 690, an attorney was employed to bring an action in behalf of a bankruptcy trustee in a state court to recover on an insurance policy. The court, at page 692, said that the attorney could not acquire "any rights in or to such assets which were not subject to the control of the court [the bankruptcy court]." It also said:

> "It is elemental law that an attorney, performing services for a trustee which he claims shall be paid out of the trust estate, must submit his claim, so far as it affects the assets of the trust estate, to the court, and that any payment to him by the trustee must be in accordance with an order of the court."

Section 247 of Chapter X requires that notice of hearing for the consideration of an application by an attorney for a trustee or the debtor for an allowance, be given to the debtor corporation, the creditors, the stockholders, indenture trustees, the Securities and Exchange Commission, and other interested persons. Section 206 gives all such persons a right to be heard on the application.

The need for these provisions is evident. The trustees have no direct financial interest in the debtor's estate. Numerous creditors and stockholders are the real parties in interest. The reorganized debtor has a very important interest. They should all have an opportunity to be heard on applications which will diminish the estate to be distributed to them.

In the reorganization proceedings they are given this opportunity. In a proceeding before the state court, no such opportunity is given.

Also, the Securities and Exchange Commission is an adviser to the reorganization court on all applications for allowances. It has no standing before the New York court.

Other safeguards are provided in the reorganization proceedings which are not applicable to proceedings in the state court.

That the compensation and other provisions of Chapter X apply to all attorneys who perform services in the administration of the estate, regardless of whether they represent the trustees only in conducting the proceeding under Chapter X, clearly appears from Section 157 of Chapter X. This section expressly recognizes that attorneys for trustees may perform services either in the proceeding itself or in other actions. It specifies different qualifications for attorneys performing services in the proceeding itself and for attorneys performing services in other actions or outside the proceedings.

The power of Congress to vest in the reorganization court exclusive jurisdiction over the compensation to be allowed to attorneys appointed by it to assist its trustees in the administration of the reorganization estate cannot be doubted. *In re Chicago, Milwaukee, St. Paul & Pacific Rr.*, 121 F. (2d) 371.

Attorneys appointed by reorganization and bankruptcy courts to conduct litigations in other courts invariably apply to the reorganization and bankruptcy courts for a determination of their fees. This was done in the following cases:

Watkins v. Sedberry, 261 U. S. 571;
In re Evans, 117 Fed. 574;
In re McKenna, 137 Fed. 611;
In re J. M. Fiske, 209 Fed. 982;
In re Stemper, 222 Fed. 690;
In re Cheney, 300 Fed. 465;
In re Levinson, 19 F. (2d) 253;

Watters v. *Hamilton Gas Co.*, 29 F. Supp. 436, 477 (971, 723).

Diligent research has failed to reveal even one case, other than the case now before this court, in which a state court has attempted to fix the amount to be paid for the services of attorneys appointed by a United States District Court in a reorganization or bankruptcy proceeding.

A. The generous allowance by the state court in this case demonstrates the need for supervision by the reorganization court over the fees to be paid to attorneys appointed by it to prosecute claims in other courts.

The undesirability of permitting another court—not directly charged with the obligation of conserving the assets of the estate from which payment must be made—to fix the fees of attorneys to be paid by the estate, is well illustrated by the case now before this court.

The court below knew that only $34,522 had been collected (R. 88) on account of the judgment in the New York action, and that the prospects were that not more than another $150,000 would be collectible. It had knowledge that a proceeding for the settlement of the judgment for $150,000 was pending before the United States District Court and that the papers in such proceeding contained "information regarding the financial responsibility of the defendants against whom the judgments were rendered" (Letter, R. 93, 94; put in evidence, R. 87, 88).

The Attorneys had copies of the foregoing papers in the reorganization proceeding. They did not put them in evidence in the state court proceeding. The state court did not request the production of these papers.

It is no answer to say that the Trustees could have submitted to the jurisdiction of the state court, and could have introduced the papers in evidence. The fact is that the federal statute regulating allowances to attorneys appointed by the reorganization court requires the United States District Judge to protect the interests of the estate; the procedure in the reorganization proceeding would have resulted in a revelation of the facts; and all creditors, stockholders and other interested parties would have been given an opportunity to present facts and be heard on the allowances. In addition, the reorganization court would have postponed making the allowance until all the facts were known, including knowledge of the compensable services rendered by others in the New York action in which the Attorneys performed their services.

The lower state court allowed $102,250 (including interest) to the Attorneys for their services in the Principal Action. After deducting approximately $14,500 for other expenses and disbursements in the action (this amount is none too great—an obligation of $2750 was incurred by the Attorneys for the services of one expert who testified on the value of securities) from the total probable collection of $190,000, the fee awarded to the Attorneys represents more than 58% of the net recovery.

This allowance is completely out of line with allowances sustained in other cases involving services in state court actions by attorneys appointed by bankruptcy and reorganization courts.

Watkins v. *Sedberry*, 261 U. S. 571; *In re J. M. Fiske & Co.*, 209 F. 982; *In re Cheney*, 300 F. 465; *In re Levinson*, 19 F. (2d) 253; *In re Barcelonx*, 9 F. Supp. 146, affd. 74 F. (2d) 288; *In re Paramount-Publix Corp.*, 10 F. Supp. 504.

POINT V.

No lien on assets of a debtor can be secured during the pendency of a proceeding under Chapter X of the Bankruptcy Act.

Liens may not be secured against property subject to the exclusive jurisdiction of a bankruptcy or reorganization court because the court itself has an overriding control over all of the debtor's property which cannot be interfered with by any lien or other assertion of interest in such property. During the pendency of the bankruptcy or reorganization proceeding, the disposition of the property is controlled completely by the court.

In place of liens and other priorities under which claims against the property of the debtor may be secured before the filing of the petition—*i. e.* before the court takes exclusive jurisdiction—a new system of rights is substituted. As stated by this Court in *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, at page 95, "The bankruptcy act prescribes its own criteria for distribution to creditors".

Section 64 of the Bankruptcy Act specifies the order of priority of the various claims against the property of an estate in an ordinary bankruptcy proceeding. In reorganization proceedings under Chapter X no priority is fixed for claims arising during the administration of the estate because no reorganization may be approved unless provision is made for the payment in full of all costs and expenses of administration (Section 216(3)).

The proper procedure for the enforcement of a claim which would normally be protected by a lien, but which arises during the course of administration by a reorganization court, is indicated in *In re Fonda Johnstown & Gloversville Railroad Co.*, 126 F. (2d) 604. The court held that state franchise taxes accruing during the pendency of the reorganization should be allowed in the reorganization proceeding and paid by the trustee as part of the expenses of administration. See also, *United States v. Wood*, 290 F. 109, aff'd 263 U. S. 680.

That a lien cannot be secured against assets of a bankrupt or debtor during the pendency of a bankruptcy proceeding or a proceeding under Chapter X, is fundamental.

In *Lazarus, Michel & Lazarus v. Prentice*, 234 U. S. 263, a lien against assets in the possession of a bankruptcy court was asserted by virtue of transactions which occurred after the filing of the petition in bankruptcy. This Court held that no lien could arise after the initiation of the bankruptcy proceeding. At page 266 of its opinion, the Court said:

> "The filing of the petition and adjudication in the bankruptcy court in New York brought the property of the bankrupts, wherever situated, into *custodia legis*, and it was thus held from the date of the filing of the petition, so that subsequent liens could not be given or obtained thereon, nor proceedings had in other courts to reach the property, the court of original jurisdiction having acquired the full right to administer the estate under the bankruptcy law. *Muller v. Nugent*, 184 U. S. 1, 46 L. ed. 405, 22 Sup. Ct. Rep. 269; *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U. S. 300, 56 L. ed. 208, 32 Sup. Ct. Rep. 96."

In *Straton* v. *New*, 283 U. S. 318, this Court, at page 321 of its opinion, said:

> "* * * The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined by the law, and is so far *in rem* that the estate is regarded as in *custodia legis* from the filing of the petition. *Acme Harvest Co.* v. *Beekman Lumber Co.*, 222 U. S. 300, 56 L. ed. 208, 32 S. Ct. 96. It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the district court having acquired the exclusive right to administer all property in the bankrupt's possession."

Only in one situation may a lien be perfected after the filing of the petition. Section 67b of the Bankruptcy Act provides that "statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof * * * may be valid against the trustee even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition * * * where * * * such liens * * * arise but are not perfected before bankruptcy, * * * if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property they shall instead be perfected by filing notice thereof with the court".

Any lien granted by Section 475 of the New York Judiciary Law is a statutory lien and falls within the provisions of Section 67b of the Bankruptcy Act. When

a lien arises under this statute before the filing of the petition in bankruptcy or reorganization, the formal procedure of perfecting the lien may occur after the filing of the petition if the lien can be perfected without seizure of the assets.

The cases of *Sherman* v. *Buckley*, 119 F. (2d) 280; *In re Cup Craft Paper Corporation*, 40 Fed. Supp. 927, and *Cup Craft Paper Corp.* v. *Federal Paper Board Co.*, 262 App. Div. 91, aff'd 289 N. Y. 671; *In re Cup Craft Paper Corp.*, 40 F. Supp. 927, aff'd sub. nom. *New York Credit Mens Assn.* v. *Schlesinger*, 126 F. (2d) 472; are cited by the Attorneys. *All* of these cases come squarely within the provisions of Section 67b. In all of these cases the lien arose prior to the filing of the petition in bankruptcy and the state court merely perfected the lien after the initiation of the bankruptcy proceedings.

In the case now before this court no lien arose prior to the filing of the petition which could be perfected after the filing of such petition.

Even where Section 67b of the Bankruptcy Act is applicable, the statute expressly provides that a lien cannot be perfected by a seizure of property of the debtor although the state law requires such seizure. In such cases the lien is perfected by a notice filed with the bankruptcy court. There can be no interference with the property by or through any other court or agency.

POINT VI.

No state court, without the consent of the reorganization court, may enforce a lien against assets of the debtor during the pendency of a proceeding under Chapter X.

Effective reorganization calls for a single agency, with complete and paramount jurisdiction over the debtor and its property, to administer the assets while the proceeding is pending and to determine all claims against the debtor or its assets.

Reorganization requires a more complete control and more inclusive jurisdiction than the court in an ordinary bankruptcy possesses. A corporation which seeks the aid of a court to effect a reorganization generally has pledged or mortgaged most of its property. It would be futile to essay a reorganization of such a corporation without including the assets which are subject to mortgages or liens. In most instances, a successful reorganization can be accomplished only if all the creditors, secured and unsecured, and all the property, whether subject to lien or not, are included.

Chapter X recognizes this need. Under express statutory provisions, the court in a reorganization proceeding under Chapter X has wider jurisdiction than in an ordinary bankruptcy proceeding.

Section 111 of the Bankruptcy Act gives to the reorganization court "exclusive jurisdiction of the debtor and its property, wherever located".

All pending bankruptcy, mortgage foreclosure, and equity receivership proceedings, and other proceedings to enforce liens against property of the debtor, are automatically stayed by the mere filing of the petition initiating the Chapter X proceedings (Section 148). Receivers and trustees appointed by state or federal courts, trustees under trust deeds, and mortgagees under mortgages, having possession of property of the debtor, must immediately recognize the superior jurisdiction of the court in the Chapter X proceeding by surrendering such property to the trustee in the Chapter X proceeding (Section 257). The court may authorize its receiver or trustee to borrow money and may authorize him to issue certificates secured by a lien on the debtor's property which may be given priority over all existing mortgages and other liens (Section 116(2)). The plan approved by the court may alter or modify the rights of secured creditors, satisfy or modify liens, direct the transfer or sale of any part of the property, cancel or modify indentures and similar instruments, and change interest rates and other terms of outstanding securities (Section 216). The court may direct mortgagees, indenture trustees, and others, to execute and deliver such instruments as may be necessary to satisfy liens or transfer property in consummation of a plan (Section 227).

All of the foregoing powers are completely inconsistent with an assertion by a state court of power to appropriate assets of the debtor to the satisfaction of liens. As the bankruptcy statute is paramount, the state court must yield its ordinary jurisdiction to the superior jurisdiction of the reorganization court. *Kalb* v. *Feuerstein*, 308 U. S. 433.

Even in an ordinary bankruptcy proceeding, no other court may, during the pendency of the proceeding, take jurisdiction of an action to enforce a lien against the assets of the bankrupt, without the consent of the bankruptcy court.

> "Though a lien be not discharged by bankruptcy, its owner may not, without the bankruptcy court's permission, institute proceedings in a state court to enforce it, since his so doing might interfere with the orderly administration of the estate."
>
> *Straton* v. *New*, 283 U. S. 318, 321.

> "Thus, while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation."
>
> *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 738.

Even if the state itself desires to assert a tax lien against assets of the debtor corporation, it must do so in the reorganization proceedings, otherwise it loses its rights. *New York* v. *Irving Trust Co.*, 288 U. S. 329, 333; *Van Huffel* v. *Harkelrode*, 284 U. S. 225-228.

The cases of *Matter of Atterbury*, 222 N. Y. 355, and *Matter of King*, 168 N. Y. 53, cited in the Attorneys' brief, are not in conflict with the foregoing principles.

Neither case involved the paramount jurisdiction of a United States District Court in a proceeding under Chapter X of the Bankruptcy Act. Neither case involved an attorney appointed by a court to assist such court in the administration of an estate.

In the case of *Matter of Atterbury* the administrator was appointed by the court to bring an action under Section 130 of the New York Decedent Estate Law for the benefit of the next of kin for damages for the wrongful death of decedent. The attorney was selected by the administrator.

In *Matter of King*, the trustee was trustee of a testamentary trust. The trustee selected the attorney.

In each case the courts involved were courts of concurrent jurisdiction, where, accordingly, either court securing jurisdiction retains that jurisdiction to the exclusion of other courts. The cases are not applicable to a situation where a valid statute gives to one of the courts exclusive jurisdiction of the assets regardless of which court first took jurisdiction.*

No case is cited in which the reorganization court, with its statutory "exclusive" jurisdiction, has been held to lose its jurisdiction over particular assets merely because it has submitted specified questions—not involving the same issues—and arising between different parties—to a state court for adjudication.

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* The lower state court herein was led into error as to the effect to be given to these cases by its assumption that the state court and the reorganization court have concurrent jurisdiction over assets of the debtor. It stated, as the rule applicable to the reorganization court in this case, that its "exclusive jurisdiction to deal with the property of the bankrupt estate is but an application of the broader rule that when a court of competent jurisdiction takes possession of property for the purpose of administering it no other court can then interfere with or disturb that possession", and that "when a state court at the time bankruptcy occurs already is proceeding to ascertain and enforce liens of a kind not invalidated by the bankruptcy * * * the bankruptcy does not oust the state court of its jurisdiction or vest the bankruptcy court with power to enjoin its proceedings" (R. 105). Obviously, this is not a correct statement of the basis or extent of the exclusive jurisdiction of the court in a proceeding under Section 77B or Chapter X.

A. Section 475 of the New York Judiciary Law does not give a state court jurisdiction to enforce an attorney's charging lien against causes of action which are assets of a debtor, during the pendency of a proceeding under Chapter X.

Section 475 of the Judiciary Law merely extends the common law charging lien of an attorney by granting such a lien at the inception of the action in which the services are rendered instead of when judgment is entered (*Matter of Heinsheimer*, 214 N. Y. 361). As the Attorneys did not assert their claim until after entry of the judgment in the New York action brought in behalf of the reorganization estate, their rights are neither greater nor less than they would be under the common law. There is no particular magic therefore in the fact that they are relying on a statute.

The charging lien of an attorney—when it exists*—is no more sacred than a mechanic's lien, or a landlord's lien, or a tax lien. State courts have jurisdiction over all of these—normally—when such jurisdiction has not been superseded by the paramount jurisdiction of a federal court in proceedings under Chapter X. No state court may, however, enforce *any* lien against the assets of a debtor after the approval of a petition under Chapter X, without the consent of the reorganization court. Even sovereign states must look to the reorganization court for the satisfaction of their tax liens, and if they fail to file their claims *in the proceedings in the reorganization court* before the expiration of the bar date fixed by such court, the claims cannot be asserted against assets of the debtor. *New York* v. *Irving Trust Co.*, 288 U. S. 329; *Van Huffel* v. *Harkrode*, 284 U. S. 225.

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* That the Attorneys have no lien appears from the discussion on pages 16-18 of this brief.

POINT VII.

The United States District Court and Trustees did not, directly or indirectly, confer jurisdiction upon the state court to fix the *amount* of the allowance to be made to the Attorneys; nor did they confer jurisdiction upon the state court to enforce any claimed *lien*.

The New York Court of Appeals has held (R. 128): (1) that there was "no waiver by the Federal court under the circumstances in the case at bar" of its "exclusive jurisdiction" "to determine these fees"; (2) that "from first to last the trustees herein have insisted upon their claim that in the case at bar jurisdiction to make allowances to these attorneys did not reside in the State court but resided in the Federal court"; and (3) that "it is unnecessary to consider whether it was within the power of the court to surrender this jurisdiction, since it would appear that both as a matter of law and as a matter of fact the retainer of these attorneys was subject to the condition that the amount of any fees would be fixed by the United States District Court".

There was therefore no *direct* waiver of jurisdiction by the federal reorganization court.

Was there an *indirect* waiver by reason of the litigation conducted in the state court by the Attorneys, in behalf of the reorganization estate, against the old Reynolds directors?

A. Effect of the submission of the controversy with the Reynolds directors to the jurisdiction of the state court.

When the reorganization court permitted the Debtor and the Trustees to institute and prosecute the action against the old Reynolds directors in the state court, it necessarily submitted to that court jurisdiction over all the issues in that action. The Debtor and Trustees were bound by the adjudication in that case: If costs had been assessed against them in that case, they would have been bound to pay such costs. If, as in *Sherman* v. *Buckley*, the Trustees had made an application in that action for an order of substitution, or any other order, and the court had imposed a condition in the order, granting the application,* the Trustees would have been bound by such condition if they had acted under the order without taking an appeal.

But surrender by the reorganization court of jurisdiction over particular issues to the state court—in this case, the issues in the controversy with the old Reynolds directors—did not constitute a general surrender of its exclusive jurisdiction over the administration of the causes of action as assets of the reorganization estate.** When

* In *Sherman* v. *Buckley*, 119 F. (2d) 280, the bankruptcy trustee applied for an order for the substitution of attorneys in the state court action. The order granting substitution expressly gave the superseded attorneys a lien for 30% of the ultimate recovery. The trustee and his substituted attorneys took no appeal, but acted under the order for more than five years.

In the case at bar, no application was made for an order of substitution, and no order of any kind, giving the attorneys a lien or fixing the amount of their compensation, was made in the state court action authorized by the reorganization court.

** Surrender of jurisdiction over the Reynolds issues to a New York court was necessary. The process of the reorganization court (the United States District Court for the District of New Jersey) was not effective in New York, where the necessary defendants resided and had their places of business.

the issues submitted to the New York court had been determined, and final judgment had been entered, the jurisdiction of the New York court came to an end.

Even before final judgment in the New York action, only the reorganization court could administer the causes of action as assets of the debtor. The New York courts could not pass upon claims of third parties against these assets. They could not authorize a settlement, or sale, or other disposition of the causes of action.

Causes of action are, obviously, assets of the reorganization estate which, like all other assets, are subject to the exclusive jurisdiction of the reorganization court. *Gochenour* v. *Cleveland Terminals Bldg. Co.*, 118 F. (2d) 89.

Chapter X itself, in Section 216(13), expressly recognizes causes of action as assets subject to the jurisdiction of the reorganization court. It provides that "such claims not settled or adjusted in the plan" shall be retained and enforced by the reorganization trustee.

The proceeding, which the Attorneys brought in the New York court, *after* the termination of the Reynolds action, was a separate and independent proceeding—conducted as an independent action—with different parties and issues. It was not, and could not be, a motion in the Reynolds action which had been authorized by the reorganization court.

As stated by the court in *Peri* v. *New York Central Rr.*, 152 N. Y. 521, at page 526, the proceeding by an attorney to enforce his lien,

"* * * is a special proceeding and cannot be

regarded in any proper sense as a motion in the action. * * *

"We have here a proceeding by third parties against the defendant upon other issues than those framed in the action and relating to a lien arising out of a state of facts wholly distinct from those passed upon at the trial. * * *

"'It is conducted as if it were an independent action.'"

Jurisdiction of the court over the parties in the action in which the attorney's services were rendered does not carry over into the special proceeding to enforce the attorney's lien. New personal service must be made as in the case of a summons (Rule 21 of New York Rules of Civil Practice).*

In the case at bar, the Attorneys seek in this separate proceeding to recover for the value of services rendered in three different New York actions, each action having different parties and involving different issues.

Even where a bankruptcy trustee appeared in a state court action and successfully moved that such action be transferred to a federal equity court, he was not precluded from thereafter successfully asserting that the equity court did not have jurisdiction because of the ex-

* It is true that Justice Walter presided at the trial of the issues in the principal Reynolds action, and also passed upon the merits of the application of the Attorneys for the enforcement of their claimed lien. But this was purely accidental. Such applications are heard in Special Term, Part I, of the New York Supreme Court. Justice Walter just happened to be sitting in this Part on January 12, 1942, the date on which the Attorneys made their application returnable. In the two entire calendar years of 1941 and 1942, Justice Walter sat in that Part a total of only five weeks: the weeks commencing April 28, 1941, August 18, 1941, *January 12, 1942*, January 19, 1942, and August 24, 1942.

clusive jurisdiction of the bankruptcy court. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 739.

B. Power of a Reorganization Court to waive its jurisdiction.

The power of a bankruptcy or reorganization court to delegate its powers or waive its jurisdiction is extremely limited.

Its jurisdiction over such matters of administration as the fixing of the fees of its agents and attorneys may not be delegated or waived. See *U. S. Fidelity & Guar. anty Co.* v. *Bray*, 225 U. S. 205, 217, 218; *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 739; *Gross* v. *Irving Trust Co.*, 289 U. S. 342, 344; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483.

Section 241 of the Bankruptcy Act expressly puts upon the reorganization judge the duty of fixing the fees of attorneys appointed by him to assist the trustees in the administration of the estate. It is the discretion of the district judge—not the discretion of any other person or tribunal—which the statute demands. The district judge cannot avoid this obligation by delegation to another court. He cannot even delegate it, under a plan, to the trustees or committees in the proceedings (*Wright* v. *City National Bank & Trust Co.*, 104 F. (2d) 285).

Even if the reorganization judge had power to delegate this important administrative function, he could, at most, delegate only his own power. He could not evade the clear mandate of statute and court rule by delegating the matter to another court free from the restrictions imposed upon him by Sections 62, 206, 247 and 249 of the

Bankruptcy Act and General Order in Bankruptcy 44. The requirements of these statutes and rules were not met in the proceeding in the state court.

In unusual situations—such as where state law must be applied and such law is unsettled—the reorganization or bankruptcy court may permit specific issues to be litigated in a state court. A lower federal court may even be reversed on appeal by this Court or the Circuit Court of Appeals for failure to exercise its power to permit litigation in a state court where justice or equity demands such litigation (as in *Foust* v. *Manson S. S. Lines*, 299 U. S. 77). But in each case, where a higher federal court reversed for failure to permit a state court action, the controversy involved a claim against a debtor or bankrupt which arose prior to the reorganization or bankruptcy proceeding; it did not involve a debt or expense of administration. And in each case it was recognized that the *reorganization or bankruptcy court* must expressly give its permission.*

This Court has recently held that it is error for a federal court, having exclusive jurisdiction over a matter, to refuse to take jurisdiction because state law is involved and such law can not be determined because of the absence of state court decisions (*Meredith* v. *Winter Haven*, 88 Supreme Court Law ed. Advance Opinions page 1). The proper procedure is for the federal court to take jurisdiction, instruct the parties by appropriate action to get a state court ruling on the disputed questions of state law, and then administer the estate in con-

* If the federal court improperly refuses permission, the remedy is by appeal and reversal. Without affirmative permission the state court does not acquire jurisdiction. See *Palmer* v. *Larchmont Manor Co.*, 284 N. Y. 288.

formity with the state law as thus established (*Mangus* v. *Miller*, 317 U. S. 178).

C. Section 475 of the New York Judiciary Law does not impose a condition upon the right of a reorganization estate or other litigant to use the state courts.

Section 475 of the New York Judiciary Law does *not* impose a condition upon the right of a litigant to use the state courts.

The statute does not exact a lien for the attorney as the price to be paid for the right to litigate issues in the state courts. It merely gives an attorney, when "it is an element, express or implied" of his agreement that he "is to be paid out of the fruits of the judgment", the right to a lien to protect his claim for services. *Matter of Heinsheimer*, 214 N. Y. 361, 368. When it exists, it is a statutory lien similar to a mechanic's lien, a landlord's lien, or a tax lien.

That Section 475 does not purport to attach a condition to the right to use the state courts clearly appears from the fact that it grants a lien whether the services are rendered in federal courts or state courts. It even grants a lien for services rendered before a "federal department". Obviously the state statute cannot attach a condition to the right to use the federal courts or to appear before federal departments.

POINT VIII.

Discussion of the *Cup Craft* and *Sherman* v. *Buckley* cases.

The Attorneys seek to justify their position by a reliance upon the case of *Sherman* v. *Buckley*, 119 F. (2d) 280; and the *Cup Craft* cases (*Cup Craft Paper Corporation* v. *Federal Paper Board Co.*, 262 App. Div. 91, affd. in 289 N. Y. 671; and *In re Cup Craft Paper Corporation*, 40 F. Supp. 927, affd. sub nom. *New York Credit Men's Assn.* v. *Schlesinger*, 126 F. (2d) 472).

The dissenting judges of the New York Court of Appeals based their dissent entirely upon the case of *Sherman* v. *Buckley* (R. 129).

The facts in Sherman v. Buckley.

The following facts appear in the record on appeal to the United States Circuit Court of Appeals in the *Sherman* v. *Buckley* case:

In 1927, one Gould retained Buckley & Buckley as his attorneys to bring an action in a state court under a 50% contingent retainer. Action was started in New York Supreme Court in May, 1927. It was tried in November, 1932. Gould was non-suited. (Record, fols. 28 and 29).

An appeal was taken in Gould's behalf by Buckley & Buckley. Over a year later, while the appeal was still pending, Gould was adjudicated a bankrupt, in January, 1934 (Record, fol. 38).

The trustee in bankruptcy did nothing. The status quo

continued for eleven months—Gould remained as party plaintiff, and Buckley & Buckley remained as attorneys for plaintiff.

On December 10, 1934, the attorneys for the trustee in bankruptcy wrote Buckley & Buckley as follows (Record, fol. 50):

> "Mr. Lyttleton B. P. Gould, the plaintiff in the above-entitled action, informed us that he wishes to substitute us for yourselves as attorneys for the plaintiff in the action now pending in the Supreme Court, New York County. We would suggest that this be done by stipulation which will preserve your lien in the case and leave to future determination by either the court or an arbitrator the amount of such lien."

In January, 1935, the bankruptcy trustee made a motion for a substitution of attorneys. Answering said motion, Buckley & Buckley requested that their lien be fixed in the order of substitution. On February 25, 1935, Justice McGoldrick made an order permitting the substitution of attorneys on condition that Buckley & Buckley have a lien for 30% of any money recovered in the action (Record, fols. 58 to 63).

The bankruptcy trustee did not object to the order. He took no appeal. He acted under the order for a period of five and one-half years. The substituted attorneys and the trustee in bankruptcy acted under the foregoing order, prosecuted an appeal, and secured a reversal of the previous adverse judgment of dismissal; and in October, 1940, secured a settlement which resulted in the entry of a judgment for $40,000 (Record, fols. 150, 151).

Immediately thereafter, also in October, 1940—more than five and one-half years after he had expressly consented to the lien, to the jurisdiction of the state court,

and to the order of the state court fixing the lien—the trustee repudiated his previous consent to the fixing of the lien by the state court and sought an injunction from the Federal court to prevent Buckley & Buckley from asserting rights under the order which had been made by the state court five and one-half years previously. The injunction was granted in the lower court, but was reversed by the Circuit Court of Appeals.

The facts in the Cup Craft cases.

The following facts are taken from the Record on Appeal of the *Cup Craft* case in the New York Court of Appeals:

Schlesinger and Krinsky, attorneys, were retained in 1939 by Cup Craft Paper Corporation to prosecute an action. A written contract of retainer provided that the attorneys were to receive $200 plus one-third of any recovery (Record, fols. 449-452). Suit was commenced in the New York Supreme Court.

In February, 1940, Cup Craft Paper Corporation filed a petition under the Bankruptcy Act. It was adjudicated a bankrupt in May, 1940.

The bankruptcy trustee moved in the state court to be substituted as party plaintiff (Record, fol. 341). The attorneys cross-moved (Record, fols. 356-357) for an order relieving them of further duties in the case and recognizing their lien for services to the bankrupt before his bankruptcy.

The court at Special Term granted the trustee's motion for substitution and the attorneys' motion to be relieved from further duties, but refused to make the order of substitution conditional upon a recognition of the lien of the attorneys for the reasonable value of their services to the bankrupt before his bankruptcy.

The Appellate Division reversed the decision of the Special Term court with the following brief opinion (262 App. Div. 91, 92):

> "*Per Curiam*: The attorneys could not be required, against their will, to represent the Trustee in Bankruptcy in lieu of the plaintiff by whom they were retained (*Matter of Dunn*, 205 N. Y. 398). Upon such a substitution, therefore, the attorneys were entitled to reasonable compensation for services theretofore rendered. The amount of their lien should be referred to an Official Referee to hear and report thereon to the court."

The Court of Appeals affirmed without opinion.

Comparison of this case with Sherman v. Buckley and the Cup Craft cases

The differences which distinguish this reorganization case from the case of *Sherman* v. *Buckley* and the *Cup Craft* cases are:

1. (a) In the *Buckley* and *Cup Craft* cases, the attorneys were not appointed by the bankruptcy court. The services were rendered to bankrupts *before* bankruptcy. (While Buckley continued on the record as attorney for Gould after the bankruptcy of Gould, there is nothing in the record to show that any services were performed by Buckley after the bankruptcy and before the substitution of attorneys—no claim was made for services after the initiation of the bankruptcy proceedings.) The claims were provable as debts of the bankrupts and were not covered by the statutory provisions regulating allowances for services in the administration of a bankruptcy or reorganization estate.

(b) In this case, all the services were rendered in the administration of a reorganization estate; the Attorneys were appointed by the reorganization court as its agents and officers and performed all their services as appointees and agents of said court. The claims were administration debts and expenses covered by the allowance provisions of the Bankruptcy Act, the orders of the reorganization court, and the plan confirmed in the reorganization proceeding.

2. (a) In the *Buckley* and *Cup Craft* cases, the services of the attorneys were rendered and the liens arose *before* the initiation of the bankruptcy proceedings.

(b) In this case, all the services were rendered *after* the initiation of the reorganization proceeding. The alleged lien, if any, arose during the pendency of the federal reorganization proceeding. No lien can arise against assets of a bankruptcy or reorganization estate *after* the initiation of the proceedings.

3. (a) In the *Buckley* and *Cup Craft* cases, liens under Section 475 of the Judiciary Law arose before the filing of bankruptcy petitions and were perfected after the bankruptcy, as expressly permitted by Section 67b of the Bankruptcy Act.

(b) In this case no lien arose prior to the filing of the reorganization petition, and no lien could arise thereafter because the property was then subject to the exclusive jurisdiction of the reorganization court. Section 67b of the Bankruptcy Act only applies to liens arising before the filing of the petition.

4. (a) The *Buckley* and *Cup Craft* cases both involved conditions imposed in orders secured by bankruptcy trus-

tees permitting substitutions of attorneys in state court actions brought by them.

(b) In this case, no order of substitution was requested or granted and no other order in the action brought by the Trustees fixed the compensation of the Attorneys or purported to give them a lien. The order was made in a separate and independent proceeding brought *by the Attorneys* after the action brought by the Trustees had terminated through the entry of judgment; such order was made despite objections made by the Trustees to the jurisdiction of the state court; and appeal was promptly taken.

5. (a) The *Buckley* and *Cup Craft* cases involved the jurisdiction of a bankruptcy court, which has no jurisdiction over property not in its possession, and which has no power to displace valid liens.

(b) This case involves the jurisdiction of a reorganization court under Chapter X of the Bankruptcy Act, which court has exclusive jurisdiction over all the property of the debtor even if it is in the possession of another court. The reorganization court has power to displace valid liens.

6. (a) In the *Buckley* and *Cup Craft* cases, the proceedings were in bankruptcy. In such proceedings no plan of reorganization is confirmed. Liens are not lost unless the court orders a sale free and clear of liens. Such orders had not been entered in either case.

(b) In this case, the proceedings were in reorganization under Chapter X of the Bankruptcy Act. In such proceedings, under Section 226, all claims against the property of the corporation are wiped out except those reserved in the plan and the order confirming the plan. The plan was confirmed June 17, 1940. It provides that only claims

allowed by the reorganization court may be asserted against the property of the debtor.

7. (a) In the *Buckley* and *Cup Craft* cases, the attorneys had contingent contracts, and they were "discharged" before the entry of judgment.

(b) In this case, the Attorneys did *not* have a contingent contract, and they were permitted to completely perform the services for which they had been employed. They entered judgment on the cause of action. They were not "discharged" by the Trustees.

8. (a) In the *Buckley* case, the bankruptcy trustee suggested that the state court grant the lien, made the motion in which the state court fixed the lien, and acted under the order of the state court fixing the lien for 5½ years. By making this motion, acting under it, and not appealing from it, it became *res judicata* as to the trustee.

(b) In this case, the Trustees have at all times contested the jurisdiction and power of the state court to fix the lien. They have not, directly or indirectly, at any time, submitted any phase of their controversy with their attorneys to the jurisdiction of the state court.

9. (a) In the *Buckley* case, the trustee repudiated the agreement which he had made with the attorneys and with the state court.

(b) In this case, the Attorneys repudiate the agreement which they made with the federal court that said court should "from time to time fix the reasonable compensation to be paid" to them "for services in the prosecution of such claims".

POINT IX.

Discussion of the arguments of, and cases cited by, the Attorneys.

The Trustees will discuss under this Point only such matters as have not already been covered in the preceding pages of this brief.

Attorneys' Point I.

The Attorneys place great reliance upon *In re Prudence Co.*, 96 F. (2d) 157.

This case sustains the contentions of the Trustees and not those of the Attorneys. The attorney had been retained by the debtor and suit had been instituted *before* the reorganization proceedings. "When the debtor's petition in reorganization was filed, Mr. Davison had as security for his fees a charging lien on his client's cause of action" (p. 160). "Bankruptcy does not invalidate such liens" (p. 160). The attorney "moved *in the reorganization proceedings* for an order permitting him to receive" payment "in satisfaction of his lien for fees" (p. 159).

Cases which hold that a reorganization trustee must comply with applicable state laws in operating a business, are not applicable. The services of the Attorneys were not performed in the operation of the Debtor's business. They were performed in the liquidation of assets.

The general rule that a receiver or trustee appointed by a court can only be sued with the permission of that

court (*Porter* v. *Sabin*, 149 U. S. 473), applies in the case at bar. The exception to this rule which is embodied in Section 66 of the Federal Judicial Code (28 U. S. C. A. 125) is not applicable, since the services of the Attorneys were not performed "in carrying on the business" of the Debtor. See *Ex parte Baldwin*, 291 U. S. 610, 617, 618.

Attorneys' Point II.

The Attorneys allege that the state court secured jurisdiction because of "the attempt of the Trustees to substitute themselves in place of the Attorneys".

The only basis for this statement is a letter from the Trustees to the Attorneys, dated June 3, 1941 (R. 22, 23), in which the Trustees stated that they did not desire to avail themselves of the services of the Attorneys after the entry of judgment and that they would themselves do whatever might be necessary thereafter to protect the interests of the estate in the causes of the action. The record shows that no application for substitution was ever made to the New York court and no such application was ever considered by it.

The facts now before this court, in this respect, are totally different from those in *Sherman* v. *Buckley*. In that case the Trustee made an application for substitution, consented to the order of substitution and the provision therein under which the lien of the attorneys was fixed, and then operated under the order for a period of five and a half years before repudiating the order.

Attorneys' Point III.

The Trustees have always conceded, and hereby again concede, that the reorganization court did not have jurisdiction (because of the restrictions imposed by Section 23 of the Bankruptcy Act) to pass upon the issues of the plenary action instituted in August 1938* against the old Reynolds directors in behalf of the reorganization estate. The federal court never claimed such jurisdiction. It permitted the Debtor and the Trustees to submit *those* issues to the jurisdiction of the New York court.

But the case at bar does not involve the jurisdiction of the reorganization court over the issues in the controversy with the old Reynolds directors. It involves the jurisdiction of the reorganization court over the fixing of the fees of attorneys appointed by it to assist in the administration of the assets of the estate, and the jurisdiction of the reorganization court over claims against property which is subject to its exclusive jurisdiction. The jurisdiction of the reorganization court over this new controversy is obviously not limited by Section 23. 2 Collier on Bankruptcy (14th ed.) pp. 446-8.

The Attorneys fail to distinguish between the exclusive jurisdiction of the reorganization court over the claim against the Reynolds directors as an asset of the estate — and the jurisdiction of a court to reduce the claim to judgment. They ignore the difference between the summary jurisdiction of the court, and its plenary jurisdiction.

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* This action was commenced, upon authorization of the reorganization court, after the initiation of the reorganization proceeding but before Chapter X became applicable to such proceeding in September 1938.

Obviously, the reorganization court had summary jurisdiction over the claim as an asset, at all times. The Attorneys themselves recognized this jurisdiction. They accepted appointment by the reorganization court and acted under its authority in instituting the action in the New York court. They recognized the exclusive jurisdiction of the reorganization court while the New York action was pending, by acting under its authority in securing a substitution of the Trustees as plaintiff in the New York action in place of the Debtor.

Although the Attorneys quote the language of Judge Maris in *In re Standard Gas & Electric Co.*, 119 F. (2d) 658, they fail to appreciate the distinction which he carefully draws between the exclusive jurisdiction of the reorganization court over the *res* (the claim itself) and claims against that *res*, and the limitation imposed upon a bankruptcy and 77B court by Section 23 of the Bankruptcy Act.

Section 23 limited the power of the reorganization court to try the issues in the action brought by the reorganization estate against the old Reynolds directors. But this does not mean that the causes of action are not assets of the reorganization estate; nor does it mean that the reorganization estate does not have exclusive jurisdiction over these causes of action as part of the *res* which is subject to its exclusive jurisdiction.

The reorganization court may be compelled to use another court to liquidate and establish the claim. But control over the claim—the exclusive power to authorize its settlement, or sale, or other disposition—the exclusive power to determine claims against it as an asset of the

estate—was at all times solely with the reorganization court.

The Chandler Act, in 1938, did not change the exclusive jurisdiction of the reorganization court over allowances to attorneys appointed by it, or over claims against property of the debtor. Such jurisdiction is the same in a proceeding under Section 77B as it is in a proceeding under Chapter X.

If the rights of the parties in this case depend on whether the reorganization court has the jurisdiction of a Section 77B or a Chapter X court—it is difficult to see how they do—then this reorganization court has all the jurisdiction conferred by Chapter X, since the petition and amended petition were "approved as duly and in good faith filed under Chapter 10 of the Bankruptcy Act of 1938" (R. 57), by order dated January 19, 1939. The controversy with these Attorneys arose in 1941, more than two years after the reorganization court commenced to exercise the powers of a Chapter X court.

Attorneys' Point IV.

The Attorneys, in asserting that "the drastic change of nullifying local attorneys' lien laws cannot be found in any of the provisions of Chapter X", imply that an attorney's lien is more sacred than any other lien, such as a tax lien or landlord's lien. Obviously, that is not the case. *No* lien can be secured during the pendency of the reorganization proceeding. No other court may interfere with the assets of a reorganization court in order to enforce a lien against such assets.

An attorney who has accepted appointment by a reorganization court is even less entitled to challenge the jurisdiction of the reorganization court over assets entrusted to him by said court, than a complete outsider whose claim does not stem from a recognition of the jurisdiction of such court.

Attorneys' Point V.

The Attorneys contend in their brief that they are not bound by the plan because they "were never parties to the Plan of Reorganization".

They were attorneys for the most important creditors' committee (representing the bondholders) and for the most important stockholders' committee (representing the preferred stockholders), and received allowances totalling $36,000 for their services in the reorganization proceeding (R. 28). They "approved the aforesaid provisions [of the plan which stated that the reorganization court would fix the amounts of their fees], and have at all times since approved similar provisions. * * *. They have, from time to time, urged the Court, the holders of debentures and shares of preferred stock and other interested parties, to approve and accept plans containing such provisions. They have never, directly or indirectly, expressed disapproval or lack of acquiescence with respect to the aforesaid provisions. The plan which was finally confirmed and actually consummated in 1940 with the entire support of applicants [the Attorneys], contains" these provisions.*

* These allegations are in paragraphs 11 and 12 (R. 30) of the Trustees' answer in the state court proceeding, and are expressly admitted in the Attorneys' reply to said answer (R. 68).

Having induced those whom they represented to believe that the reorganization court would fix their fees for services in the prosecution of these claims, the Attorneys now repudiate their agreement. They claim that while the plan is binding upon the bondholders and stockholders whom they represented, it is not binding upon them!

The Trustees request that the order of the New York Court of Appeals be affirmed.

Respectfully submitted,

JOHN GERDES,
JAMES D. CARPENTER, JR.,
As Trustees of Reynolds Investing Company, Inc., Debtor, Pro Se, Respondents.

JOHN GERDES,
MARY-CHASE CLARK,
Of Counsel.

December 8, 1943.

APPENDIX.

State Statutes.

New York Decedent Estate Law.

§130. *Action by executor or administrator for negligence or wrongful act or default causing death of decedent.*

The executor or administrator duly appointed in this state, or in any other state, territory or district of the United States, or in any foreign country, of a decedent who has left him or her surviving a husband, wife, or next of kin, may maintain an action to recover damages for a wrongful act, neglect or default, by which the decedent's death was caused, against a natural person who, or a corporation which, would have been liable to an action in favor of the decedent by reason thereof if death had not ensued. Such an action must be commenced within two years after the decedent's death. When the husband, wife or next of kin, do not participate in the estate of decedent, under a will appointing an executor, other than such husband, wife or next of kin, who refuses to bring such action, then such husband, wife or next of kin shall be entitled to have an administrator appointed for the purpose of prosecuting such action for their benefit.

New York Judiciary Law, Sections 474 and 475.

§474. *Compensation of attorney or counsellor.*

The compensation of an attorney or counsellor for his services is governed by agreement, express or implied, which is not restrained by law. * * *

§475. *Attorney's lien in action, special or other proceeding.*

From the commencement of an action, special or other proceeding in any court or before any state or federal

department, except a department of labor, or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action, claim or counterclaim, which attaches to a verdict, report, determination, decision, judgment or final order in his client's favor, and the proceeds thereof in whatever hands they may come; and the lien cannot be affected by any settlement between the parties before or after judgment, final order or determination. The court upon the petition of the client or attorney may determine and enforce the lien.

NEW YORK RULES OF CIVIL PRACTICE.

Rule 21. *Manner of service of papers to begin a proceeding.*

The provisions of the statutes and rules relating to the mode of personal service of a summons shall apply to the service of any process or other paper whereby a proceeding is begun in a court, or before an officer, except a proceeding to punish for contempt, unless other special provision for the service thereof is made by law or rule. Other papers in a proceeding shall be served in like manner as in an action.

Federal Statutes.

JUDICIAL CODE, SECTION 66

(28 U. S. C. A. 125).

SEC. 125. Suits against receiver. Every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the

court in which such receiver or manager was appointed: but such suit shall be subject to the general equity jurisdiction of the court in which such manager or receiver was appointed so far as the same may be necessary to the ends of justice.

FEDERAL BANKRUPTCY ACT.

SEC. 23. JURISDICTION OF UNITED STATES AND STATE COURTS.—a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act.

SEC. 62. EXPENSES OF ADMINISTERING ESTATES; UNAUTHORIZED SHARING OF FEES; WITHHOLDING ALLOWANCES. a. The actual and necessary costs and expenses incurred by officers in the administration of estates shall, except where other provisions are made for their payment, be reported in detail, under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred. * * *

c. A custodian, receiver, or trustee or the attorney for any of them, or any other attorney, rendering services in a proceeding under this Act or in connection with such proceeding, shall not in any form or guise share or agree to share his compensation for such services with any person not contributing thereto, or share or agree to share in the compensation of any person rendering services in a proceeding under this Act or in connection with such proceeding, to which services he has not contributed: *Provided, however,* That an attorney-at-law may share such compensation with a law partner or with a forwarding attorney-at-law, and may share in the compensation of a law partner.

d. A custodian, receiver, or trustee or the attorney for any of them, or any other attorney, seeking compensation for services rendered by him in a proceeding under this Act or in connection with such proceeding, shall file with the court his petition setting forth the value and extent of the services rendered, the amount requested and what allowances, if any, have theretofore been made to him. Such petition shall be accompanied by his affidavit stating whether an agreement or understanding exists between the petitioner and any other person for a division of compensation and, if so, the nature and particulars thereof. If satisfied that the petitioner has, in any form or guise, shared or agreed to share his compensation or in the compensation of any other person contrary to the provisions of this subdivision, the court shall withhold all compensation from such petitioner.

SEC. 64. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the filing fees paid by creditors in involuntary cases;

where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600, to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this title, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the Court: And

provided further, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law; Provided, however, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

b. Debts contracted while a discharge is in force or after the confirmation of an arrangement shall, in the event of a revocation of the discharge or setting aside of the confirmation, have priority and be paid in full in advance of the payment of the debts which were provable in the bankruptcy or arrangement proceeding, as the case may be.

SEC. 67. * * *

b. The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to

be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

SEC. 111. Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

SEC. 116. Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court— * * *

(2) authorize a receiver, trustee, or debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to issue certificates of indebtedness for cash, property, or other consideration approved by the judge, upon such terms and conditions and with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable; * * *

SEC. 148. Until otherwise ordered by the judge, an order approving a petition shall operate as a stay of a prior pending bankruptcy, mortgage foreclosure, or equity receivership proceeding, and of any act or other proceeding to enforce a lien against the debtor's property.

SEC. 157. An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: Provided, however, That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

SEC. 206. The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter. * * *

Federal Bankruptcy Act.

SEC. 216. A plan of reorganization under this chapter—

(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

(2) may deal with all or any part of the property of the debtor;

(3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge;

(4) may provide for the rejection of any executory contract except contracts in the public authority;

(5) shall specify what claims, if any, are to be paid in cash in full;

(6) shall specify the creditors or stockholders or any class of them not to be affected by the plan and the provisions, if any, with respect to them;

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property, free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

(8) shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either as provided in the plan or in the order confirming the plan, (a) by the sale of such property at not less than a fair upset price; or (b) by appraisal and payment in cash of the value of their stock; or (c) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection: Provided, however, That such protection shall not be required if the judge shall determine that the debtor is insolvent;

(9) may include, where any indebtedness is created or extended under the plan for a period of more than five years, provisions for the retirement of such indebtedness by stated or determinable payments out of a sinking fund or otherwise, (a) if secured, within the expected useful life of the security therefor, or (b) if unsecured, or if the expected useful life of the security is not fairly ascertainable, then within a specified reasonable time, not to exceed forty years;

(10) shall provide adequate means for the execution of the plan, which may include: the retention by the debtor of all or any part of its property; the sale or transfer of all or any part of its property to one or more other corporations theretofore organized or thereafter to be organized; the merger or consolidation of the debtor with one or more other corporations; the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price and the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein; the satisfaction or modification of liens; the cancelation or modification of indentures or of other

similar instruments; the curing or waiver of defaults; the extension of maturity dates and changes in interest rates and other terms of outstanding securities; the amendment of the charter of the debtor; the issuance of securities of the debtor or such other corporations for cash, for property, in exchange for existing securities, in satisfaction of claims or stock or for other appropriate purposes;

(11) shall include provisions which are equitable, compatible with the interests of creditors and stockholders, and consistent with public policy, with respect to the manner of selection of the persons who are to be directors, officers, or voting trustees, if any, upon the consummation of the plan, and their respective successors;

(12) shall provide for the inclusion in the charter of the debtor, or any corporation organized or to be organized for the purpose of carrying out the plan, of—

(a) provisions prohibiting the debtor or such corporation from issuing non-voting stock, and providing, as to the several classes of securities of the debtor or of such corporation possessing voting power, for the fair and equitable distribution of such power among such classes, including, in the case of any class of stock having a preference over other stock with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and

(b) (1) provisions which are fair and equitable and in accordance with sound business and accounting practice, with respect to the terms, position, rights, and privileges of the several classes of securities of the debtor or of such corporation, including, without limiting the generality of the foregoing, provisions with respect to the issuance, acquisition, purchase, retirement or redemption of any such securities, and the declaration and payment of dividends thereon; and (2) in the case of a

debtor whose indebtedness, liquidated as to amount and not contingent as to liability, is $250,000 or over, provisions with respect to the making, not less than once annually, of periodic reports to security holders which shall include profit and loss statements and balance sheets prepared in accordance with sound business and accounting practice;

(13) may include provisions for the settlement or adjustment of claims belonging to the debtor or to the estate; and shall provide, as to such claims not settled or adjusted in the plan, for their retention and enforcement by the trustee or, if the debtor has been continued in possession, by an examiner appointed for that purpose; and

(14) may include any other appropriate provisions not inconsistent with the provisions of this chapter.

SEC. 221. THE JUDGE SHALL CONFIRM A PLAN IF SATISFIED THAT—* * *

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; * * *

SEC. 226. The property dealt with by the plan, when transferred by the trustee to the debtor or other corporation or corporations provided for by the plan, or when transferred by the debtor in possession to such other corporation or corporations, or when retained by the debtor in possession, as the case may be, shall be free and clear of all claims and interests of the debtor, creditors, and stockholders, except such claims and interests as may otherwise be provided for in the plan or in the

order confirming the plan or in the order directing or authorizing the transfer or retention of such property.

SEC. 227. The court may direct the debtor, its trustee, any mortgagees, indenture trustees, and other necessary parties to execute and deliver or to join in the execution and delivery of such instruments as may be requisite to effect a retention or transfer of property dealt with by a plan which has been confirmed, and to perform such other acts, including the satisfaction of liens, as the court may deem necessary for the consummation of the plan.

SEC. 241. The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act. * * *

SEC. 247. The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, except that, in the case of allowances for services and reimbursement in a superseded bankruptcy proceeding, notice need be given only to the applicants, the debtor, the trustee, and the unsecured creditors, and may be given to such other classes of creditors or other persons as the judge

may designate. In the case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that bankruptcy be proceeded with, notice of the hearing to consider allowances need not be given to stockholders.

SEC. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter, shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

SEC. 257. The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.

SEC. 276 c. The provisions of sections 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout

the United States", approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings;

General Orders in Bankruptcy.

Order 44.

APPOINTMENT OF ATTORNEYS.

No attorney for a receiver, trustee or debtor in possession shall be appointed except upon the order of the court, which shall be granted only upon the verified petition of the receiver, trustee or debtor in possession, stating the name of the counsel whom he wishes to employ, the reasons for his selection, the professional services he is to render, the necessity for employing counsel at all, and to the best of the petitioner's knowledge all of the attorney's connections with the bankrupt or debtor, the creditors or any other party in interest, and their respective attorneys. If satisfied that the attorney represents no interest adverse to the receiver, the trustee, or the estate in the matters upon which he is to be engaged, and that his employment would be to the best interests of the estate, the court may authorize his employment, and such employment shall be for specific purposes unless the court is satisfied that the case is one justifying a general retainer. If without disclosure any attorney acting for a receiver or trustee or debtor in possession shall have represented any interest adverse to the receiver, trustee, creditors or stockholders in any matter upon which he is employed for such receiver, trustee, or debtor in possession, the court may deny the allowance of any fee to such attorney, or the reimbursement of his expenses, or both, and may also deny any allowance to the receiver or trustee if it shall appear that he failed to make diligent inquiry into the connections of said attorney. * * *